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SUBJECT: HOW MUCH CAN LATVIA'S NEW GOVERNMENT EXPECT TO
ACHIEVE?

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Classified By: Charge d'affaires a.i., Bruce D. Rogers. Reason: 1.4 (d
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11. (C/NF) Summary: The Dombrovskis government is an uneasy coalition that faces very difficult economic choices that will strain political support and heighten personality conflicts within the government. At the same time, leaders seem to understand that continued political instability will only exacerbate the economic situation and are likely to muddle through at least until local government elections June 16. While several political observers here believe that this government could survive through scheduled national elections in October 2010, we are less sanguine. There are plenty of opportunities for missteps along the way. The President is unlikely to move to dismiss the parliament, which also would give the parties some room to maneuver because he cannot credibly make the same threat of dismissal again. The key player is the People's Party. Their acquiescence to staying in the backseat is the key to the survival of the Dombrovskis government. Foreign and defense policy are likely to remain unchanged, but take on a lower priority as the government focuses on economic issues. End summary.

12. (C/NF) The approval of the new Latvian government led by Valdis Dombrovskis marks a pause in the political turmoil that has disrupted Latvia for several months, but it does not mark a resolution. The government faces many challenges, most notably a deepening economic crisis. If Latvia is to meet the terms of its agreements with the EU, IMF and other donors, it must cut roughly another 1.3 billion USD from the budget. Dombrovskis says he will seek agreement from lenders to allow a higher budget deficit and lower cuts, but there is no guarantee that will happen. The initial cuts he has proposed are largely mechanical and reliant on borrowing from the pension surplus. There is still no strategic approach to decide what core functions the state must provide and how much to allocate to each one. Moreover, both Dombrovskis' own finance minister and the head of the central bank oppose a higher deficit. In either case, the needed cuts will be painful; it is only a question of how painful. In that context, the comprehensive reforms in education and health care promised in return for international assistance will require politically difficult school and hospital closures in depopulating rural areas. To date, no political leader has really been able to explain to average Latvians why these cuts are needed and how they will benefit in the long term. While Latvians are a patient people, we expect that there will be increased opposition to the cuts as they are unveiled and implemented. Already, there is a constitutional court case to reverse the decision to deny pensioners a cost of living adjustment in 2009.

13. (C/NF) The government also faces challenges largely born of personalities. One of the coalition parties, Civic Union, is made up of people who left two other coalition parties, New Era and Fatherland and Freedom. The bitterness of those splits still lingers. Dombrovskis is also not the head of

his own New Era party, but rather the consensus choice among the party's various factions. In fact, he was not even involved in the negotiations with People's Party on forming this new government. Having been out of Latvia in Strasbourg since 2004, he lacks personal connections with many of the other ministers and political leaders. As a result, his ability to knock heads and drive agreements, the way Godmanis and Kalvits could, is limited.

14. (C/NF) The biggest wild card in the new government is Finance Minister Einars Repse. As PM in 2002 - 2004, Repse had a reputation for being unable to work with others and for failing to consider opinions other than his own. He was also famously forced to announce "I am not from Mars" in response to complaints about his unusual personal behavior. Since being appointed to this new job, he has been on his best behavior, but many observers wonder how long that can last. Repse has had a series of failed business deals in recent years and whispers of personal scandals. These, along with his well known ties to controversial banker/publisher Valery Belokan, will doubtless provide fodder for political opponents.

15. (C/NF) While the above are all reasons for concern, there is some reason for optimism. Politicians seem to finally understand the gravity of the crisis. A number of maximalist positions staked out during the coalition negotiations, such as those by People's Party to retain control of distribution of EU structural funds or to draw a "red line" on cuts in the health sector were rejected without reprisal. Also, as one of its first acts after approving the new government, the parliament voted overwhelmingly to eliminate advisory

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16. (C/NF) Several political observers have told us that they could easily see this government lasting through scheduled parliamentary elections in October 2010, but we are less sure. Local government elections on June 6, especially the results in Riga, will be a key indicator of the mood of the country. The results of those elections could easily force some changes in the makeup of the government. Even after that, the pain of the decisions facing Latvia and the disruption likely to be caused by reductions in government services will create incredible strain on the coalition and could drive it apart as easily as draw it closer together.

17. (C/NF) It seems likely that President Zatlers will decide that by March 31 enough has been done to meet the conditions he set out January 14 that he will not seek to dismiss the Saeima. Indeed, the only remaining major issue is passage of constitutional amendments allowing the public to initiate a dismissal of Saeima, which now seem likely to pass. But if Zatlers decides not to initiate a dissolution, it is not a threat he can use again. With that threat lifted and once local government elections are past, the parties will have more room for political maneuver.

18. (C/NF) The key to stability of this government is the People's Party (TP). They still have the largest number of seats in parliament and if they leave the coalition, they are very hard to replace. We agree with one former TP advisor who said the party is in an ideal situation at the moment. Early elections (where they would have faced big losses) seem unlikely, they don't have any of ministries saddled with making politically difficult cuts (except health, but they can blame Repse for those), and it is likely that infighting will break out among others in the coalition. At the same time, TP will likely do well in local government elections in the countryside and they have the ministers of foreign affairs, culture and justice where they project a positive image of their work for Latvia. Once they think the worst of the cuts are done, they could very easily decide that they are ready to return to leadership, especially as the 2010 elections get closer.

19. (C/NF) A final word on the government's foreign and security policy. While we expect it to remain

trans-atlanticist, it is largely an afterthought. These sections of the government declaration were largely copied from previous ones and, unlike in previous cases, no bureaucrats from MFA or MOD were invited to help in the drafting. Given the budget situation, Latvia simply cannot afford to take on new tasks in these areas and will struggle to meet the obligations it has. Two positive signs, though, are that the government declaration specifically cites the primacy of the mission in Afghanistan and at the inaugural meeting of the government, President Zatlers was strongly supported when he said that is in Latvia's own interest to fulfill its international obligations despite the economic challenges of doing so.

ROGERS